

## Message Text

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PASS CEA (GREENSPAN), TREASURY (WIDMAN), FRB (WALLICH)

E.O.11652: N/A

TAGS: ECON, OECD

SUBJECT: ECONOMIC POLICY COMMITTEE (EPC) MEETING,  
MARCH 9-10: OECD RECOVERY ON COURSE; POLICY  
OFFICIALS EXAMINE HOW TO ASSURE ITS DURABILITY

REFS: (A) OECD PARIS 5441, (B) OECD PARIS 7415,  
(C) CPE(76)2, (D) OECD PARIS 33074,  
(E) OECD PARIS 7689

1. SUMMARY: REVIEW OF SHORT-TERM PROSPECTS OF MAJOR  
OECD COUNTRIES AT MARCH 9-10 EPC MEETING EASILY REACHED  
CONSENSUS THAT (A) RECOVERY APPEARS MORE FIRM THAN FORE-  
SEEN AT LAST EPC (NOVEMBER 1975); (B) THERE IS LITTLE  
DANGER THAT OECD GROWTH WILL FALL BELOW THE 4-4.5 PER-  
CENT NOW FORECAST BY SECRETARIAT (SLIGHT UPWARD REVISION  
OF DECEMBER "ECONOMIC OUTLOOK"), AND (C) AT THE MOMENT  
NO FURTHER STIMULUS IS NECESSARY OR APPROPRIATE. ACCORD-  
INGLY, MAIN FOCUS OF TWO-DAY DISCUSSION WAS WHAT FISCAL  
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AND MONETARY POLICY STANCE WAS APPROPRIATE IN UPTURN TO

ASSURE SUSTAINABILITY OF RECOVERY, ESPECIALLY RESTORATION OF PRIVATE SECTOR CONFIDENCE. LATTER RECOGNIZED BY EPC MEMBERS AS A PRECONDITION FOR REACHING ADEQUATE LEVEL OF PRIVATE INVESTMENT WHICH IMPORTANT FOR A DURABLE, NON-INFLATIONARY RECOVERY. MOST MAJOR COUNTRIES (U.S., FRG) FELT THAT RAPID SHIFTS IN POLICY WERE A PRIMARY CAUSE OF CLIMATE OF UNCERTAINTY AND THAT CORRECTIVE MEDICINE WAS STEADINESS. OTHERS (U.K., SOME SMALLS) LEANED MORE TOWARD FINE-TUNING. SECRETARIAT WAS SPLIT (MARRIS A FINE-TUNER; VAN LENNEP' STEADY). COUNTRIES OPTING FOR STEADIER POLICIES TENDED TO BE THOSE WHICH FELT THEY HAD SUBSTANTIAL MONETARY INDEPENDENCE AND RELATIVELY STABLE MONETARY/REAL RELATIONSHIP. THESE COUNTRIES WERE ALSO THOSE THAT WERE MOST SUPPORTIVE OF PUBLICLY-ANNOUNCED MONETARY TARGETS (INTEREST RATES OR AGGREGATES) TO HELP REDUCE INSTABILITY AND GRADUALLY TO BRING DOWN INFLATION RATES. MAJORITY OF EPC SEEMED TO FEEL (EXPLICITLY OR IMPLICITLY) THAT BOTH UNEMPLOYMENT AND INFLATION WOULD BE HIGHER OVER MEDIUM TERM THAN IN PAST (I.E. 1960'S) PARTLY DUE TO STRUCTURAL CHANGES. TO HELP ADJUST STRUCTURAL PROBLEMS AND TO MINIMIZE UNEMPLOYMENT AND INFLATION INCREASED PRIVATE INVESTMENT WOULD BE NECESSARY. DISCUSSION THUS CAME FULL-CIRCLE BACK TO NEED TO RESTORE PRIVATE-SECTOR CONFIDENCE. WP-2 CHAIRMAN (SKANLAND) GAVE REPORT ON STATUS OF HIS GROUP'S MEDIUM-TERM GROWTH STUDY ALONG LINES OF REF A. EPC EXPANDED BUREAU MET MARCH 9 AND DISCUSSED TRADE ISSUES (REF B), RECENT EVENTS (I.E. STERLING DROP), AND SHORT- AND MEDIUM-TERM PROSPECTS WITH EMPHASIS ON CONFIDENCE ISSUE (SEE PARA 13). NEXT EPC PLENARY MEETING TENTATIVELY SET FOR JUNE 28-29. END SUMMARY.

#### GENERAL IMPRESSIONS

2. SHORT-TERM GROWTH OUTLOOK: (COUNTRY DETAILS PARAS 18 TO 29) REVIEW BY MAJOR COUNTRIES OF THEIR PROSPECTS FOR 1976 CONFIRMED SECRETARIAT'S RECENT QUALITATIVE JUDGMENT (REF C) THAT OVERALL OECD REAL GNP WOULD GROW AT SLIGHTLY HIGHER RATE IN 1976 THAN FORESEEN IN DECEMBER "ECONOMIC OUTLOOK." MOREOVER, WHEREAS AT LAST LIMITED OFFICIAL USE

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NOVEMBER'S EPC MEETING SECRETARIAT HAD TO BE CONVINCED BY COUNTRIES THAT RISK OF FORECAST ERRORS WERE SYMMETRICAL RATHER THAN ON DOWNSIDE, SECRETARIAT HAS NOW JOINED NATIONAL DELEGATES IN BELIEVING THAT DOWNSIDE RISK IS MINIMAL AND THAT THERE IS LITTLE CHANCE THAT OECD 1976 GROWTH WILL FALL BELOW 4-4.5 PERCENT PROJECTED BY SECRETARIAT AT PRESENT.

3. WHILE OVERALL 1976 GROWTH PICTURE WAS FAVORABLE, PROSPECTS FOR INDIVIDUAL MAJOR COUNTRIES WERE SOMEWHAT DIFFERENTIATED. SECRETARIAT AGREED WITH U.S. DEL (GREENSPAN) THAT U.S. RECOVERY IS ON TRACK, AND SEES 6 PERCENT GROWTH OF REAL GNP AS LIKELY OUTCOME DESPITE POSSIBLE CONTINUED WEAKNESS IN CONSTRUCTION SECTOR AND

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IN GROWTH OF REAL DISPOSABLE INCOME. IN EUROPE, FRANCE AND FRG PERFORMING BETTER THAN PREVIOUSLY EXPECTED. SECRETARIAT ESTIMATE THAT FOR BOTH COUNTRIES STOCK DECUMULATION WAS COMPLETED BY END OF 1975 AND THAT MODERATE GROWTH OF FINAL DEMAND AND SOME STOCK ACCUMULATION WILL RESULT IN GROWTH RATES IN 4-4.5 PERCENT RANGE. SECRETARIAT BELIEVES JAPANESE SITUATION MORE DISAPPOINTING AND WHILE NOT ALTERING DECEMBER FORECAST OF 4.5 PERCENT REAL GNP GROWTH, IT LEFT IMPRESSION THAT RISKS ARE ON DOWNSIDE AND STATED THAT ATTAINMENT OF 5-6 PERCENT JAPANESE TARGET WAS HIGHLY UNLIKELY. JAPANESE, HOWEVER,

CONTESTED SECRETARIAT'S PESSIMISM.

4. SHORT-TERM PRICE OUTLOOK: SITUATION FOR 1976 LOOKS SOMEWHAT BETTER THAN AT LAST EPC MEETING. MAIN FEATURE OF RECENT MONTHS HAS BEEN SHARP RISE IN COMMODITY PRICES WHICH, IN SECRETARIAT VIEW, PRIMARILY RESULT OF TURN-AROUND IN INVENTORIES. SECRETARIAT BELIEVES THAT IF GROWTH IN OECD FINAL DEMAND IN 1976 REMAINS AT OR UNDER LIMITED OFFICIAL USE

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5 PERCENT, COMMODITY PRICE INCREASES WILL NOT UPSET RELATIVELY ENCOURAGING PRICE FORECAST.

5. SUSTAINABILITY OF UPTURN IN MEDIUM TERM: IN CONTRAST WITH RELATIVELY APTIMISTIC NEAR-TERM OUTLOOK, MANY COUNTRIES AND SECRETARIAT HIGHLIGHTED DIFFICULTIES OF PARLAYING UPTURN FROM RECESSION INTO SUSTAINABLE NON-INFLATIONARY RECOVERY. IN ADDITION TO INFLATION/UNEMPLOYMENT DILEMMA AND STRUCTURAL SHIFTS, MANY DELEGATES FELT A KEY ISSUE WAS CONTINUING LACK OF PRIVATE-SECTOR CONFIDENCE REFLECTED IN STILL HIGH SAVINGS RATIOS AND WEAKNESS IN INVESTMENT SPENDING. FEAR WAS EXPRESSED THAT FLAGGING INVESTMENT WOULD RESULT IN CAPACITY SHORTAGES AT FAIRLY EARLY POINT IN UPSWING CHOKING OFF RECOVERY BEFORE UNEMPLOYMENT COULD BE LOWERED TO ACCEPTABLE LEVELS. MOREOVER, IT WAS FELT THAT UNCERTAINTY IN PRIVATE SECTOR HAD EFFECT OF DEFLECTING IMPACT OF MONETARY AND FISCAL POLICIES AND GREATLY COMPLICATING DEMAND MANAGEMENT.

6. PROBLEMS OF STRUCTURE: SEVERAL COUNTRIES EXPRESSED GENERAL VIEW THAT STRUCTURAL PROBLEMS AND SHIFTS WERE MAIN REASON WHY MEDIUM TERM HELD PROSPECT OF BOTH HIGHER INFLATION AND UNEMPLOYMENT THAN HAD PREVIOUSLY EXISTED (E.G. IN 1960'S). U.K. (HOPKINS) POINTED TO VAGUENESS OF TERM "STRUCTURAL" AND SUGGESTED SPECIFIC ALTERNATIVE DEFINITIONS: REGIONAL OR SKILL-RELATED MISMATCHES OF LABOR DEMAND AND SUPPLY; MISMATCHES OF AGGREGATE DEMAND AND SUPPLY DUE TO CHANGES IN COMPOSITION OF DEMAND BECAUSE OF RELATIVE PRICE SHIFTS (ESPECIALLY ENERGY). EPC DISCUSSION SUGGESTED THAT, LOOKED AT IN THIS WAY, PROBLEM OF STRUCTURE IS REALLY ONE OF INVESTMENT, AND THAT CHIEF QUESTION IS THEREFORE HOW TO RESTORE PRIVATE-SECTOR CONFIDENCE TO GENERATE NECESSARY INVESTMENT.

7. MONETARY AND FISCAL POLICY STANCE FOR UPTURN: ALTHOUGH THERE WAS WIDE AGREEMENT IN EPC THAT DISSIPATION OF PRIVATE-SECTOR UNCERTAINTY WAS CENTRAL OBJECTIVE, COUNTRIES WERE NOT UNANIMOUS ON STANCE OF MONETARY AND FISCAL POLICIES CONSISTENT WITH ITS ACHIEVEMENT.

MANY COUNTRIES (ESPECIALLY U.S., CANADA, FRG) ARGUED  
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THAT POLICY SHIFTS WERE A MAJOR SOURCE OF UNCERTAINTY  
AND HENCE THAT SOLUTION WOULD BE MORE STEADINESS. SEVERAL  
COUNTRIES SUPPORTING THIS ARGUMENT ALSO FAVORED ANNOUNCED  
TARGETS FOR MONETARY POLICY (AGGREGATES AND/OR INTEREST  
RATES). OTHER COUNTRIES (E.G. U.K.) ARGUED THAT  
EXPANSION OF MARKETS AND HENCE OF AGGREGATE DEMAND WAS  
ESSENTIAL TO INDUCE INCREASED INVESTMENT. VARIANT OF  
THIS VIEW, EXPRESSED BY MARRIS AND SOME SMALLER  
COUNTRIES, WAS THAT DEMAND MANAGEMENT POLICIES SHOULD  
SHIFT IN COUNTER-CYCICAL MANNER AND THAT IN CURRENT  
SITUATION PROPER STANCE MIGHT BE TO EXPAND AGGREGATE  
DEMAND IN COMBINATION WITH INCOMES POLICY TO IMPROVE  
EMPLOYMENT/INFLATION TRADEOFF. EPC REACHED NO CONSENSUS  
ON THESE BASIC DIFFERENCES IN APPROACH, ALTHOUGH THERE  
SEEMED TO BE A SENSE OF GROWING SUPPORT FOR MORE STEADI-  
NESS AND PREDICTABILITY IN POLICIES. AT SAME TIME,  
MARRIS SUGGESTED COUNTRIES SHOULD BE LOOKING AHEAD AT  
DANGER OF EARLY RENEWAL OF SYNCHRONIZED OVERHEATING,  
AND BE READY TO APPLY DISCRETIONARY POLICY RESPONSES.

#### FISCAL AND MONETARY POLICY

8. FISCAL POLICY: DISCUSSION OF FISCAL POLICY FOCUSED  
ON FOUR RELATED ISSUES: (A) APPROPRIATE STANCE OF

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FISCAL POLICY AT CURRENT POINT IN UPTURN; (B) USEFULNESS OF FISCAL POLICY AS COUNTER-CYCLICAL INSTRUMENT; (C) INFLUENCE OF FISCAL POLICY SHIFTS ON PRIVATE-SECTOR CONFIDENCE; (D) SIZE AND COMPOSITION (CYCLICAL VS. STRUCTURAL) OF BUDGET DEFICITS. MOST COUNTRIES FELT THAT IN VIEW OF STRONG GROWTH OUTLOOK FURTHER FISCAL STIMULUS WAS NEITHER NECESSARY NOR APPROPRIATE AT THIS TIME. U.S. (GREENSPAN) ADDED THAT OUR CAPACITY TO RESPOND TO FORECAST ERRORS WAS NOT SYMMETRICAL IN THAT IT IS FAR EASIER TO INJECT MORE FISCAL STIMULUS IF RESULTS FALL SHORT OF FORECASTS THAN TO ACT IN OPPOSITE SITUATION. ACCORDING TO U.S., THIS LACK OF SYMMETRY COMBINED WITH LEAD TIME OF DECISION-MAKING PROCESS AND EFFECT OF POLICY SHIFTS IN CREATING UNCERTAINTY (AND OFFSETTING BEHAVIOR) IN PRIVATE SECTOR ARGUED STRONGLY FOR HOLDING STEADY COURSE NOW AND FOR DE-EMPHASIZING FISCAL POLICY AS COUNTER-CYCLICAL TOOL. FRG, CANADA AND JAPAN ECHOED U.S. POSITION AGAINST FURTHER FISCAL STIMULUS, AND FRG POINTED OUT THAT INCREASING SIZE OF LIMITED OFFICIAL USE

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BUDGET DEFICIT WOULD ONLY LEAD PRIVATE SECTOR TO EXPECT TAX INCREASES AND THUS TO REDUCTION IN PROPENSITY TO SPEND. FRG CALLED FOR STEADINESS IN FISCAL POLICY AND COMMENTED THAT FREQUENT SHIFTS HAD DESTROYED SPONTANEOUS SELF-CORRECTING MECHANISMS INHERENT IN THE ECONOMIC PROCESS. VAN LENNEP SUPPORTED THE "STEADY AS SHE GOES" PHILOSOPHY.

9. CONTRASTING VIEW HELD BY SECRETARIAT (MARRIS) AND BY SEVERAL SMALLER COUNTRIES, WHICH ARGUED THAT FISCAL POLICY COULD BE FLEXIBLE DEMAND MANAGEMENT TOOL. MARRIS, GREEKS AND NETHERLANDS, FOR EXAMPLE, FELT THAT FURTHER STIMULUS MIGHT USEFULLY BE COMBINED WITH INCOMES POLICIES. SWedes COMMENTED THAT FISCAL POLICY COULD BE DESIGNED SO AS TO RETAIN GOVERNMENTAL CONTROL OVER

PRIVATE-SECTOR SPENDING DECISIONS, REDUCING EXTENT TO WHICH PRIVATE-SECTOR BEHAVIOR COULD OFFSET STIMULATORY MEASURES. AS EXAMPLES, THEY CITED INVENTORY ACCUMULATION SUBSIDIES AND INVESTMENT FUND SCHEME EMPLOYED BY GOS TO MAINTAIN HIGH EMPLOYMENT LEVELS DURING 1974. (SEE REF E.)

10. ALTHOUGH EPC REACHED NO CLEAR CONSENSUS ON EFFECTIVENESS OF FISCAL POLICY AS AN ANTI-CYCLICAL INSTRUMENT, THERE WAS AGREEMENT ON NEED TO REDUCE PRESENT LARGE GOVERNMENT DEFICITS AS A PRECONDITION FOR SHIFT OF OUTPUT COMPOSITION TOWARD INVESTMENT. MOST COUNTRIES FELT THAT A SIGNIFICANT PORTION OF THEIR PUBLIC-SECTOR DEFICIT WAS STRUCTURAL RATHER THAN CYCLICAL, WOULD NOT BE ELIMINATED IN UPSWING, AND THUS THAT DISCRETIONARY REDUCTIONS IN EXPENDITURE OR INCREASES IN TAXES WOULD BE NECESSARY TO PRODUCE BUDGETARY BALANCE.

11. MONETARY POLICY: MONETARY POLICY DISCUSSION CONCENTRATED ON (A) APPROPRIATE STANCE OF MONETARY POLICY AT CURRENT STAGE OF UPTURN; (B) UTILITY OF SETTING TARGETS (INTEREST RATES OR AGGREGATES) TO REDUCE RATE OF INFLATION OVER TIME AND TO MINIMIZE ADVERSE EFFECTS OF MONETARY POLICY SHIFTS ON INFLATIONARY EXPECTATIONS AND INTEREST RATES; (C) WHETHER ANNOUNCEMENT OF TARGETS WOULD BE DESIRABLE. U.S. (GREENSPAN)

ARGUED THAT FURTHER RELAXATION OF MONETARY POLICY WOULD BE UNDESIRABLE, SINCE ADDITIONAL MONETARY STIMULUS WOULD GENERATE INFLATIONARY EXPECTATIONS AND INCREASE RISK PREMIUMS IN FINANCIAL MARKETS WHICH WOULD HAVE A GREATER DAMPENING EFFECT ON INVESTMENT THAN WOULD SOME RISE IN INTEREST RATES CAUSED BY COMBINATION OF INCREASED DEMAND FOR FUNDS IN RECOVERY AND MODERATE GROWTH IN MONEY SUPPLY. THUS, U.S. FELT THAT STEADY AND MODERATE INCREASE IN MONEY SUPPLY, BY AVOIDING DESTABILIZING SHIFTS, WOULD REDUCE INFLATION RATE AND KEEP RISK PREMIUMS DOWN. FRG, CANADIANS, JAPANESE (AND TO SOME DEGREE FRENCH) ECHOED U.S. SENTIMENTS. FRG AND JAPANESE STRESSED THAT INVESTMENT SPENDING WAS DETERMINED MORE BY SUCH FACTORS AS PROFITS AND BUSINESS OUTLOOK THAN BY INTEREST RATES, AND THEREFORE REJECTED FURTHER RELAXATION OF MONETARY POLICY.

12. U.S. (WALLICH) FELT THAT SETTING MONETARY TARGETS WOULD REDUCE DESTABILIZING POLICY SHIFTS AND WOULD HELP BRING DOWN INFLATION RATE OVER MEDIUM TERM, AND THAT ANNOUNCING TARGETS WOULD REINFORCE THESE EFFECTS. U.S.

NOTED, HOWEVER, THAT CIRCUMSTANCES COULD LEAD TO SHIFTS  
IN TARGETS AND/OR IN THE APPROPRIATE VARIABLES TO BE

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CONTROLLED, AND POINTED TO OBSCURE MOVEMENTS OF U.S.  
MONETARY AGGREGATES IN FOURTH QUARTER OF 1975 (I.E.  
DRAMATIC INCREASE IN VELOCITY - WHICH CHARACTERISTIC OF  
UPTURN - WEAK RISE IN M1 RELATIVELY STRONG RISE IN M2,  
FALL IN INTEREST RATES). WHILE COMMENTING THAT RECENT  
CHANGES ALLOWING PAYMENTS TO BE MADE FROM SAVINGS  
ACCOUNTS HAD PROBABLY ECONOMIZED ON USE OF M1 (BUT NOT  
M2), U.S. NOTED THAT THIS PHENOMENON HAD NOT BEEN COM-  
PLETLY EXPLAINED AND THAT M2 WAS CURRENTLY BEING USED  
AS TARGET. U.S. ALSO STRESSED NEED FOR FLEXIBILITY  
BETWEEN INTEREST RATES AND AGGREGATES IN CHOICE OF  
TARGETS (I.E. WHEN DEMAND FOR MONEY SHIFTS AUTHORITIES  
COULD STABILIZE INTEREST RATES TO ISOLATE REAL SECTOR  
FROM THE SHIFT; WHEREAS IF INSTABILITY EMMANATES FROM  
PRIVATE SECTOR AUTHORITIES COULD ACT ON AGGREGATES IN

ORDER TO STABILIZE INTEREST RATES). FRG, CANADA AND JAPAN SUPPORTED U.S. VIEWS ON SETTING TARGETS, BUT JAPANESE FELT THAT GOJ CONTROL OF MONEY SUPPLY WAS NOT SUFFICIENT TO ALLOW ANNOUNCEMENT OF TARGETS. U.K.  
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STATED THAT IN ITS OWN CASE MONETARY/REAL RELATIONSHIPS WERE NOT STABLE (OR EVEN IDENTIFIED) AND REJECTED TARGETS. MOST SMALL COUNTRIES COMMENTED THAT THEIR LACK OF MONETARY INDEPENDENCE MADE SELECTIVE CREDIT CONTROLS A MORE VIABLE POLICY THAN ESTABLISHMENT OF TARGETS FOR INTEREST RATES OR AGGREGATES. IN GENERAL, COUNTRIES VIEWS AT EPC ON ESTABLISHING TARGETS MIRRORED THOSE EXPRESSED AT DECEMBER WP-4 MEETING (SEE REF D).

EPC BUREAU DISCUSSION

13. (THIS SECTION (PARAS 13-17) BASED ON BRIEFING GIVEN BY CHAIRMAN GREENSPAN BUT NOT CLEARED BY HIM.) AT MARCH 9 MEETING OF EPC'S RESTRICTED "BUREAU," MEMBERS (IN ADDITION TO DISCUSSING TRADE RESTRICTIONS) FOCUSED AT LENGTH ON NEED TO RESTORE PRIVATE-SECTOR CONFIDENCE. IT WAS FELT THAT IN FACE OF PRIVATE-SECTOR UNCERTAINTY INVESTMENT SPENDING WOULD REMAIN WEAK AND THAT RECOVERY WOULD BE STRANGLED BY PHYSICAL CONSTRAINTS AND BY ACCELERATION OF PRICE INCREASES BEFORE UNEMPLOYMENT COULD BE REDUCED TO ACCEPTABLE LEVEL. QUESTION OF WHETHER EPC COULD HAVE MORE PUBLIC ROLE IN RESTORING CONFIDENCE WAS RAISED BUT LEFT OPEN.

14. U.K. (WASS) TOLD BUREAU MEMBERS THAT RECENT FALL IN STERLING WAS AN "ACCIDENT" AND THAT BOE HAD BEEN SELLING STERLING IN ORDER TO MODERATE RATE OF APPRECIATION, BUT THAT MARKET HAD MISINTERPRETED BOE ACTIONS AS AN ATTEMPT TO SET CEILING ON STERLING RATE. RESULT WAS DOWNWARD SPECULATIVE PRESSURE WHICH WAS REINFORCED BY MARKET'S INTERPRETING BANK RATE DECLINE AS OFFICIAL ENCOURAGEMENT OF DEPRECIATION. VIEW OF BUREAU WAS THAT "ACCIDENTS" USUALLY HAPPEN TO ACCIDENT-PRONE CURRENCIES, AND THAT WHILE ADJUSTMENT WAS ERRATIC, STERLING DEPRECIATION REFLECTED FUNDAMENTAL MARKET FORCES. WASS FELT \$1.94 WAS PROBABLY RIGHT LEVEL FOR STERLING. NOT SURPRISINGLY, FRANCE (DE LAROSIERE) PREFERRED \$2.00.

15. U.K. COMMENTED THAT IMPROVEMENT OF MEDIUM-TERM PROSPECTS WOULD DEPEND CRUCIALLY ON SECOND (POST-AUGUST 1976) WAGE ROUND. WASS ASSERTED THAT HMG HAS EMBARKED  
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ON EDUCATIONAL EFFORT TO CONVINCE UNIONS THAT ACCELERATION OF WAGE INCREASES WOULD INEVITABLY LEAD TO RISING UNEMPLOYMENT AND TO INFLATION, AND THAT MAIN EFFECT OF PRICE CONTROLS WOULD BE TO SQUEEZE PROFITS, INVESTMENT AND JOBS. HE DESCRIBED SELECTIVE EMPLOYMENT-CREATING MEASURES AS COSMETIC AND POLITICAL.

16. ITALIANS (PALUMBO) PRESENTED NOTHING NEW, BUT COMMENTED THAT ECONOMIC POLICY CONDITIONS REQUESTED BY IMF CAUSED POLITICAL PROBLEMS.

17. DE LAROSIERE EXPRESSED CONCERN OVER SHORT-TERM INFLATION AND CURRENT ACCOUNT PROSPECTS (FRENCH ARE, HOWEVER, SATISFIED WITH PRESENT MILD DEFICIT), BUT NOTED THAT THERE WOULD BE PROBLEMS IN CONTAINING UNION DEMANDS FOR EXCESSIVE WAGE INCREASES IF RATE OF INCREASE IN CONSUMER PRICES COULD NOT BE HELD AT 8 PERCENT OR LOWER.

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INDIVIDUAL COUNTRY PROSPECTS FOR 1976

L8. US: USDEL (GREENSPAN) LED OFF DISCUSSION OF SHORT TERM PROSPECTS BY STRESSING THAT RECENT DEVELOPMENTS POINTED TO SUSTAINED RECOVERY IN U.S. AND COMMENTED THAT INVENTORY DECUMULATION HAS ONLY RECENTLY BEEN COMPLETED AND THAT PROCESS OF ACCUMULATION IS EXPECTED TO EXTEND OVER SEVERAL QUARTERS PROVIDING SUPPORT FOR RECOVERY. IN ADDITION U.S. POINTED TO STRENGTH IN LEADING INDICATORS AND CAPITAL INVESTMENT PROSPECTS (IMPROVEMENTS IN CORPORATE CASH FLOW, PROFITS, LIQUIDITY AND EXPENDITURE PLANS), ALL OF WHICH SUGGEST STEADY AND DURABLE GROWTH OF FIXED INVESTMENT. U.S. STATED THAT RECENT PRICE DATA INDICATED UNWINDING OF INFLATIONARY EXPECTATIONS AND CONSEQUENT REDUCTION OF PRESSURE ON FINANCIAL MARKETS WHICH IN TURN HAS LED TO DISSIPATION OF UNCERTAINTY AND RESTORATION OF PRIVATE SECTOR CONFIDENCE. U.S. EMPHASIZED THAT RESULT WOULD BE LIMITED OFFICIAL USE

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REDUCTION OF RISK PREMIUMS ON INVESTMENT, FALL IN SAVINGS RATE AND MINIMAL DEFLECTION OF MACRO-ECONOMIC POLICY IMPACT. WHILE ACKNOWLEDGING THAT PRESENT WEAKNESS IN RESIDENTIAL CONSTRUCTION INTRODUCED SOME UNCERTAINTY RATE 1976 OUTLOOK, U.S. NOTED THAT REDUCTION OF EXCESS CAPACITY TOGETHER WITH RELAXED MORTGAGE MARKET AUGURED WELL FOR FUTURE.

19. U.S. FELT THAT REIGNITION OF INFLATIONARY TINDER WAS MAJOR FACTOR WHICH COULD UNDERMINE RECOVERY AND THAT BOTH FISCAL AND MONETARY POLICY FOR 1976 (SEE PARAS 8 AND 10) WERE CONSISTENT WITH U.S. GROWTH FORECAST (6 - 6.5) AND WITH NEED TO CONTROL PRICE INCREASES. REFERRING TO PROSPECTIVE EVOLUTION OF WAGES AND PRICES IN U.S. DURING 1976, NETHERLANDS ASKED WHETHER WAGE INCREASES IN U.S. WERE LARGELY AUTONOMOUS OR INDUCED (I.E., DETERMINED AS FUNCTION OF PRICE CHANGES). U.S. RESPONDED THAT WAGE INCREASES BASICALLY INDUCED, AND THAT ALTHOUGH MAJOR UNION CONTRACTS WERE UP FOR NEGOTIATION IN EARLY 1976, ONLY 25% OF U.S. LABOR FORCE WAS UNIONIZED. U.S. ADDED THAT PRODUCTIVITY INCREASES WOULD DILUTE IMPACT OF WAGE INCREASES ON UNIT LABOR COSTS AND ON PRICES.

20. COMMENTING ON INTERNATIONAL IMPLICATIONS OF U.S. 1976 RECOVERY, U.S. DEL (WIDMAN) NOTED THAT PROJECTED

SWING OF \$12 BILLION TOWARD DEFICIT IN U.S. TRADE ACCOUNT IN 1976 (COMPARED WITH SWING OF \$6 BILLION FORECAST BY SECRETARIAT) WOULD HAVE LARGE POSITIVE EFFECTS ON EUROPEAN EXPORT GROWTH. U.S. ADDED THAT WHILE \$6-7 BILLION OF SWING ATTRIBUTABLE TO INCREASED FUEL IMPORTS (AND HENCE WOULD HAVE NO IMPACT ON EUROPEAN GROWTH), MAGNITUDE OF OVERALL SWING COULD WELL BE LARGER THAN \$12 BILLION FORECAST.

21. JAPAN: JAPAN (INAMURA) DISAGREED WITH SECRETARIAT VIEW THAT SIGNS OF WEAKENING OF RECOVERY ARGUED FOR SOME DOWNWARD REVISION OF DECEMBER SECRETARIAT FORECAST OF 4.25 PERCENT GROWTH IN 1976 GDP, AND THAT FURTHER STIMULUS MIGHT BE NEEDED DURING THE YEAR. SECRETARIAT ARGUED THAT FINANCIAL CONSTRAINTS AT LOCAL LEVEL HAD LIMITED OFFICIAL USE

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DELAYED IMPLEMENTATION OF SEPTEMBER REFLATIONARY PROGRAMS AND THAT GROWTH OF REAL DISPOSABLE INCOME IN 1976 WAS LIKELY TO BE NEGLIGIBLE. JAPANESE COUNTERED THAT PROJECTED INCREASE IN REAL DISPOSABLE INCOME IN 1976 IS 3 PERCENT (12 PERCENT INCREASE IN TOTAL WAGE EARNINGS, INFLUENCED IN PART BY DECLINE IN UNEMPLOYMENT RATE FROM 1.9 TO 1.7 PERCENT, MINUS 9 PERCENT INCREASE IN CONSUMER PRICES), THAT MEASURES WERE BEING TAKEN TO RELIEVE FINANCIAL BURDEN AT LOCAL LEVEL AND THAT STRONG EXPORT PICTURE INCREASED EVIDENCE FOR REALIZATION OF 5-6 PERCENT INCREASE IN REAL GNP FORECAST FOR 1976. JAPANESE CONCLUDED THAT FURTHER STIMULATORY MEASURES WERE NEITHER NECESSARY NOR APPROPRIATE AT THIS TIME. AFTER HEARING JAPANESE ARGUMENTS, SECRETARIAT (ANDERSEN) DECIDED TO RETAIN 1976 GROWTH FORECAST OF 4.25, BUT GAVE IMPRESSION THAT BALANCE OF RISK HAD SHIFTED TO DOWNSIDE AND STATED VIEW THAT ATTAINMENT OF 5.6 JAPANESE GROWTH TARGET WAS HIGHLY UNLIKELY. ANDERSEN ALSO COMMENTED THAT FROM INTERNATIONAL STAND-POINT EXPORT-LED GROWTH WAS NOT APPROPRIATE FOR A COUNTRY WHICH SHOULD PLAY MAJOR ROLE IN GENERATING RECOVERY IN OECD AREA. JAPANESE FELT THAT 1976 GROWTH WOULD BE MORE BALANCED THAN IMPLIED BY SECRETARIAT, BUT THEIR VIEW WOULD SEEM TO BE CONTRADICTED BY

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EA-07 FRB-03 INR-07 IO-11 NEA-10 NSAE-00 USIA-06

OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 OMB-01

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FACT THAT JAPANESE FORECAST SMALLER 1976 CURRENT  
ACCOUNT DEFICIT THAN DOES SECRETARIAT.

22. FRG: FRG DEL (TIETMEYER) DESCRIBED GERMAN  
OFFICIAL VIEWS OF 1976 PROSPECTS AS BEING  
IN ROUGH AND GENERAL ACCORD WITH THOSE OF SECRETARIAT  
IN THAT BOTH PARTIES HAD REVISED THEIR FORECASTS  
UPWARD SINCE DECEMBER. SECRETARIAT RAISED ITS 1976  
FORECASTS FROM 3.25 PERCENT TO 4 - 4.5 PERCENT; FRG  
MOVED ITS ESTIMATED RANGE OF 1976 GROWTH FROM 3 PERCENT  
- 7 PERCENT IN DECEMBER TO PRESENT EXPECTED RANGE OF  
4.5 PERCENT - 6.5 PERCENT. FRG FEELS THAT 1976 GROWTH  
WILL BE GENERATED BY INCREASED EXPORTS, AND EXPANSION  
OF DOMESTIC DEMAND WITH IMPORTANT FEATURE OF LATTER  
BEING FALL IN SAVINGS RATIO FROM 17 PERCENT IN 1975 TO  
14.5 PERCENT IN 1976. FRG EMPHASIZED THAT FALL IN  
SAVINGS RATIO NOT ONLY POINTED TO PROSPECTIVE INCREASE  
IN PRIVATE CONSUMPTION, BUT REVIVAL OF PRIVATE SECTOR  
CONFIDENCE WHICH WOULD HELP GUARANTEE SUSTAINABILITY OF  
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RECOVERY IN GENERAL.

23. FRG COMMENTED THAT WHILE EFFECT U.S. RECOVERY ON OTHER ECONOMIES HAS GENERALLY BEEN FAVORABLE, IMPACT ON GERMANY HAD BEEN DILUTED BY APPRECIATION OF MARK VIS-A-VIS DOLLAR. NONETHELESS, OVERALL FRG CONCLUSION WAS THAT ITS OWN RECOVERY WOULD BE DURABLE AND THAT ALTHOUGH GROWTH IN 1976 WOULD MAINLY LEAD REDUCTION IN SHORT-TIME WORK RATHER THAN TO AN INCREASE EMPLOYMENT, FRG FELT THAT FURTHER STIMULUS OF AGGREGATE DEMAND WOULD NOT BE APPROPRIATE AND THAT, IF NECESSARY, FURTHER SELECTIVE STIMULUS TO EMPLOYMENT WOULD BE CONSIDERED INSTEAD (ESPECIALLY IN LIGHT OF FRG DESIRE TO HOLD PRICE INCREASES TO EXPECTED 1976 RATE OF 4.5 - 5 PERCENT).

24. SECRETARIAT (FAY) NOTED THAT GERMAN TARGET FOR AVERAGE GROWTH OF MONEY SUPPLY (CENTRAL BANK MONEY STOCK) IN 1976 OVER 1975 WAS 8 PERCENT, AND THAT BECAUSE OF SPURT IN MONEY SUPPLY GROWTH AT END OF 1975 RATE OF INCREASE DURING 1976 WOULD HAVE TO BE NEGIGLIBLE WITH INHIBITING EFFECTS ON RECOVERY. TIETMEYER RESPONDED THAT GROWTH IN MONEY SUPPLY WAS GEARED TO MEDIUM-TERM GROWTH AND PRICE CONSIDERATION, AND THAT IN ANY CASE VELOCITY INCREASES WOULD ASSURE SUFFICIENT MONETARY GROWTH TO LUBRICATE EXPECTED EXPANSION OF NOMINAL GNP DURING 1976.

25. ITALY: ITALIANS (PALUMBO) STATED THAT PROGRESS IN REDRESSING CURRENT ACCOUNT DURING 1975 HAD BEEN UNWOUND BY HEAVY CAPITAL OUTFLOWS AT END OF YEAR. AFTER TOUCHING LIGHTLY ON POLITICAL FACTORS UNDERLYING SPECULATION AGAINST LIRA, ITALIANS STRESSED THAT CAPITAL OUTFLOWS WERE IMPORTANTLY ATTRIBUTABLE TO DECLINE IN INTEREST RATES ACCOMPANYING END-YEAR EXPANSION IN MONEY SUPPLY, ITSELF NECESSITATED BY SHARP FALL IN DOMESTIC DEMAND. AMONG SPECIFIC POLICY MEASURES INTRODUCED TO HELP PREVENT RECURRENCE OF JANUARY EVENTS, ITALIANS MENTIONED INCREASE IN DISCOUNT RATE, IN COMPULSORY BANK RESERVES AND IN REIMBURSEMENT REQUIREMENTS OF CREDIT BANKS. THEY EMPHASIZED THAT TIGHTER (COMPARED WITH THOSE APPLIED IN DECEMBER) LIMITS ON GOVERNMENT DEFICITS

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AND ON ITS MONETIZATION IMPOSED BY EC UNDER BORROWING AGREEMENTS WOULD REDUCE PROJECTED CURRENT ACCOUNT DEFICIT TO \$500 MILLION (VERSUS \$1 BILLION FORECAST IN DECEMBER), BUT AT COST OF REDUCING PROJECTED 1976 GDP GROWTH RATE FROM 1.7 PERCENT TO 1.2 PERCENT (ALTHOUGH PROJECTED INCREASE IN GDP DEFLATOR WOULD FALL FROM 16.7 PERCENT TO 16.1 PERCENT).

26. U.K.: U.K. (WASS) EMPHASIZED DECELERATION OF PRICES DURING 1975 FROM 28 PERCENT PER ANNUM IN FIRST HALF OF YEAR TO 14 PERCENT IN SECOND HALF, WITH SUCCESS LARGELY ATTRIBUTABLE TO 6-POUND WAGE LIMIT. THEY POINTED TO SEVERAL SIGNS (INCREASE IN EXPORTS AND PRIVATE CONSUMPTION; END OF STOCK DECUMULATION) AS ELEMENTS OF STRENGTH, BUT NEVERTHELESS USED TERMS SUCH AS "GENTLE PICKUP" AND "MODEST BEGINNINGS OF UPSWING" TO DESCRIBE 1976 GROWTH PROSPECTS.

27. U.K. STATED (AND STRESSED CONFIDENTIALITY OF THEIR STATEMENT) THAT CONTROL OF WAGE INCREASES IN SECOND ROUND (POST AUGUST 1976) NEGOTIATIONS WOULD BE CRUCIAL

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IN DETERMINING SUCCESS IN FIGHT AGAINST INFLATION AND CURRENT ACCOUNT DETERIORATION. THEY EXPLAINED THAT HMG GOAL WAS TO SET NORMS FOR NOMINAL WAGE INCREASES, AND THAT OBJECTIVE WAS TO PRODUCE CONTINUED DECELERA-

TION OF WAGE INCREASES (WHICH MEANS ANNUAL INCREASES OF LESS THAN THE 10 PERCENT IMPLIED BY 6-POUND LIMIT). HMG STRATEGY DURING CURRENT DELICATE PHASE OF WAGE NEGOTIATIONS IS TO REDUCE DEMANDS FOR WAGE INCREASES BY REDUCTIONS IN DIRECT TAXATION, AND ADDED THAT LIMITATION OF NOMINAL WAGE INCREASES SHOULD NOT BE CONSIDERED DEFLATIONARY, SINCE TAX REDUCTIONS WOULD MORE THAN OFFSET SHORT-FALL IN NOMINAL WAGES.

28. CANADA: CANADA (NEUFELD) GENERALLY AGREED WITH SECRETARIAT ASSESSMENT OF 1976 EVALUATION OF CANADIAN ECONOMY, AND FORECASTS 5 PERCENT INCREASE IN GNP, 9.5 PERCENT INCREASE IN CONSUMER PRICES AND \$4.5 BILLION CURRENT ACCOUNT DEFICIT. SECRETARIAT FELT EVALUATION OF ANTI-INFLATION PROGRAM WOULD BE PREMATURE. CANADIANS LIMITED OFFICIAL USE

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COMMENTED THAT SOME REDUCTION IN WAGES HAD BEEN OBTAINED IN SHORT RUN, BUT THAT FULL EFFECTS OF PROGRAM WOULD BE FELT GRADUALLY OVER TIME AND THAT, "UNFORTUNATELY", A QUICK FIX WAS NOT IN THE OFFING.

29. FRANCE: FRENCH (CORTESSE) NOTED THAT RISE IN LABOR PRODUCTIVITY AND STOCK ACCUMULATION WOULD BE ENGINE OF GROWTH IN 1976, AND THAT GDP COULD INCREASE BY 4 - 4.5 PERCENT AT MINIMUM AND 6 PERCENT AT MAXIMUM. FRENCH ALSO PROJECT MODERATE WAGE INCREASES IN 1976 AND CONSUMER PRICE INCREASE OF 8.5 PERCENT. THEY WERE NOT COMPLACENT CONCERNING RISK OF INFLATION AND CURRENT ACCOUNT DETERIORATION' AND NOTED THAT PRICE CONTROLS AND THREAT OF REIMPOSING CONJUNCTURAL TAX SHOULD HELP MODERATE INFLATIONARY PRESSURES AND THAT PRESENTATION OF BALANCED BUDGET FOR 1976 WAS DESIGNED TO COMPLEMENT SPECIFIC PRICE CONTROL MEASURES. MOREOVER, FRENCH (DE LAROSIERE) ADDED THAT MAXIMUM CREDIT CEILING IMPOSED IN 1976 WOULD LIMIT INCREASE IN SUPPLY OF CREDIT TO 12 PERCENT DURING YEAR.

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